



**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

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J. TYLER McCAULEY
AUDITOR-CONTROLLER

November 28, 2000

To: Supervisor Gloria Molina, Chair
Supervisor Yvonne Brathwaite Burke
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: J. Tyler McCauley
Auditor-Controller

Subject: **INTERNAL CONTROL REPORT**

Pursuant to Government Code Section 26920 through 26923, we examined the Treasurer and Tax Collector's (TTC) records relative to the amount and type of assets in the Treasury. On September 5, 2000, we sent to your Board our most recent report on the Treasurer's Cash and Investments as of December 31, 1999.

As part of our audit, we performed an internal control review that involved testing transactions, reviewing documents, and interviewing staff to determine if internal controls are effective and are operating as intended. Our review determined that adequate internal controls are in place and functioning as intended. However, we did identify the following areas where some improvements can be made.

Comments and Recommendations

Changes in Investment Policy

Government Code Sections 27133 and 53646 require the County Treasurer to annually render to the Board of Supervisors and the Oversight Committee a statement of investment policy, which the Board of Supervisors shall review and approve. Any change in the policy needs to be reviewed and approved by the Board of Supervisors. In addition, the investment policy shall be monitored by the County's Treasury Oversight Committee. The County's investment policy includes a description of permitted investments including the maximum investment limits by type of security.

We noted that, as of June 30, 2000, the amount invested in repurchase agreements exceeded investment policy limits. At that time, the Treasury pool contained

\$523,227,000 in repurchase agreement securities, which exceeded the investment policy maximum limit for repurchase agreement securities of \$500,000,000.

To document the change in investment policy, the Treasurer issued an internal memo increasing the repurchase agreement limit from \$500 million to \$1 billion in total. The memo authorized the increase from June 30th to July 14th to facilitate the orderly investment of large cash inflows that occurred in late June and early July from proceeds from tax revenue anticipation notes and State subventions. The change in investment policy was not reported to the Board of Supervisors or the Oversight Committee.

Treasurer management indicated that they are authorized to change the investment policy without notification to the Board of Supervisors or the Oversight Committee since the approved investment policy states that the Treasurer is authorized to operate outside the limitations set forth in the investment policy under special circumstances. We are concerned that under such an interpretation of the investment policy, the policy could be changed at any time and not be reported to the Board of Supervisors or the Oversight Committee.

Based on our discussion with the Treasurer, the Treasurer agrees to include any changes in investment policy in the monthly report to the Board of Supervisors and the quarterly report to the Treasury Oversight Committee.

Purchased Interest Reported

Interest bearing investments earn interest from the day the security is issued until the day it matures. Interest earnings are accrued daily and paid by the issuer to the owner of record at a pre-determined date(s). When an interest bearing security is sold with accrued interest, the purchasing party pays the seller the accrued interest amount. The interest earnings purchased are accounted for separately as a part of the capital outlay at the time the security is purchased. Purchased interest is repaid through the interest distributions received at the specified distribution date of the securities. The Treasurer's monthly Investment Report to the Board of Supervisors includes historical and not the remaining purchased interest for all investments as of month end. Purchased interest should indicate the net amount of interest outstanding from the capital outlay.

For example, the report of investments for December 31, 1999 reported purchased interest at \$35,824,924 rather than the net amount of \$14,802,083, resulting in an overstatement of \$21,022,841. At June 30, 2000, the overstatement was \$18,150,416.

Reporting purchased interest at original amounts does not accurately reflect the purchased interest as of the report date. The Treasurer's investment data system reports purchased interest at the original amount rather than the net amount as of the report date, the Treasurer's amount reported for purchased interest does not reflect the interest payments outstanding.

Treasurer management indicated that they are in process of replacing their investment data system, and that the investment report generated from the new system will not

include purchased interest in the monthly report to the Board of Supervisors. The Treasurer believes that the Government Code does not require purchased interest to be reported to the Board of Supervisors. Since the amount of purchased interest currently reported is not accurate, the Treasurer should modify their current investment report to no longer report purchased interest.

Recommendation

1. **The Treasurer modify the investment report to no longer report purchased interest.**

Treasurer's Response

The Treasurer agrees to implement Recommendation 1.

Community Improvement Bond Investment

The Department of Public Works distributes the cost of some community improvement (CI) projects proportionately among benefiting parcel owners. Each parcel owner has the opportunity to pay their share in full or the County issues a bond secured against their parcel. The County sells the CI bonds through public auction and the purchaser becomes the registered bondholder. The Treasurer receives each CI bond payment and forwards the amount received to the bondholder. To account for the payments, Treasurer staff maintains a bond register that indicates the current balance of each bond. If a parcel owner becomes delinquent, it is the bondholder who must initiate legal proceedings to recover the delinquent amount. The County's General Fund purchased the CI bonds for one project on October 29, 1979.

During our review, we noted that the CI bonds in the General Fund portion of the Special Purpose Investment fund as of December 31, 1999 totaled \$139,329. However, we noted that three bonds totaling \$62,572 were in foreclosure over three years ago and the Treasurer has suspended proceedings. In order to properly account for the loss on investments, the Treasurer should resume foreclosure proceedings and adjust the market value balance of the bonds, as appropriate.

Recommendation

2. **The Treasurer resume foreclosure proceedings and adjust the market value balance of the bonds, as appropriate.**

Treasurer's Response

The Treasurer agrees to implement Recommendation 2.

Trust Deed Investment Reconciliation

During our review of the Treasurer's reconciliation of investments held by Bank of America for Flying Triangle and Abalone Cove trust deeds as of December 31, 1999, we identified a \$6,477 difference between the Treasurer's records and the information obtained from Bank of America for these investments. At June 30, 2000, this difference increased to \$11,801. According to Treasurer management, they reconcile the trust deed amounts internally and do not have the time or staff available to reconcile these investments to the bank records. If no reconciliation is performed to the bank records, posting errors could go undetected and investment balances could be over/under stated. The Treasurer should reconcile Flying Triangle and Abalone Cove trust deed investments to the bank records at least quarterly and resolve any reconciling items.

Recommendation

- 3. The Treasurer reconcile Flying Triangle and Abalone Cove trust deed investments to the bank records at least quarterly and resolve reconciling items timely.**

Treasurer's Response

The Treasurer agrees to implement Recommendation 3.

Trust Fund Reconciliation

The County Fiscal Manual requires trust funds to be reconciled monthly to the Countywide Accounting and Purchasing System or quarterly if fewer than five transactions per month occur. As part of our review, we verified that the Treasurer's staff reconciles trust funds as prescribed. However, we noted that the Adams and Grand trust fund has not been reconciled since it was established on February 11, 1999. The account balance was \$43,676.21 at June 30, 2000.

The Treasurer's staff indicated that this is a temporary fund established to pay bills for a non-profit corporation and will reconcile the account once all the bills are paid. Per the Treasurer, the Board of Directors for the non-profit corporation are no longer available. As a result, the Treasurer cannot close the account. To ensure that errors or irregularities do not occur and remain undetected, the Treasurer should require staff to reconcile the Adams and Grand trust fund as required by the County Fiscal Manual. In addition, the Treasurer should work with County Counsel to dissolve the corporation and appropriately distribute the amount remaining in the trust fund.

Recommendations

- 4. The Treasurer require staff to reconcile the Adams and Grand trust fund monthly, or quarterly if fewer than five transactions per month occur.**

5. The Treasurer work with County Counsel to dissolve the corporation and appropriately distribute the amount remaining in the trust fund.

Treasurer's Response

The Treasurer agrees to implement Recommendations 4 and 5.

Review of Report

On November 2, 2000, we met the Treasurer to discuss the comments and recommendations. The Treasurer has agreed to implement the recommendations as indicated above.

JTM:PTM:IDC

c: David E. Janssen, Chief Administrative Officer
Mark Saladino, Treasurer and Tax Collector
Violet Varona-Lukens, Executive Officer
Public Information Officer
Audit Committee